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RUEHDS/AMEMBASSY ADDIS ABABA 2066
RUEHBY/AMEMBASSY CANBERRA 1343
RUEHDK/AMEMBASSY DAKAR 1700
RUEHKM/AMEMBASSY KAMPALA 2122
RUEHNR/AMEMBASSY NAIROBI 4553
RUEAIIA/CIA WASHDC
RUEHGV/USMISSION GENEVA 1201
RHEHAAA/NSC WASHDC
RHMFISS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEFDIA/DIA WASHDC//DHO-7//
RUCPDOC/DEPT OF COMMERCE WASHDC
RUZEJAA/JAC MOLESWORTH RAF MOLESWORTH UK//DOOC/ECMO/CC/DAO/DOB/DOI//
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C O N F I D E N T I A L SECTION 01 OF 05 HARARE 000363

SIPDIS

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AF/S FOR S. HILL
NSC FOR SENIOR AFRICA DIRECTOR B. PITTMAN
STATE PASS TO USAID FOR L.DOBBINS AND E.LOKEN
TREASURY FOR J. RALYEA AND T.RAND
COMMERCE FOR BECKY ERKUL, J.DIEMOND
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS

E.O. 12958: DECL: 04/23/2018
TAGS: ECON ETRD PGOV ASEC ZI
SUBJECT: SURVIVOR ZIMBABWE: HOW BUSINESS COPES

REF: A. HARARE 280
¶B. HARARE 277
¶C. HARARE 232

Classified By: Charge d'Affaires, a.i. Kathy Dhanani for reason 1.4 (d)

1.(U) SUMMARY: The government of Zimbabwe's erratic and destructive economic policies--outlandish quasi-fiscal spending, punitive price controls, and foreign exchange retention--have wreaked havoc on businesses, forcing many to reduce their production levels dramatically. Eager to be well-positioned for a turnaround, most firms are struggling to consolidate their position in the market. To survive, businesses have found ways to work around the rules, diversified into other geographic and product markets, and slimmed down their costs. Reduced demand was not a business constraint for the companies, and most felt it would only take a few weeks to a few months to expand capacity again given a conducive environment. END SUMMARY.

Companies Face Similar Constraints, Employ Similar Strategies

2.(C) Regional Affairs Officer traveled throughout Zimbabwe meeting with businesses in manufacturing, tourism, and mining to discover tenacious CEOs and Managing Directors fighting to keep their companies alive. The business leaders laid out similar constraints on their productivity: lack of foreign exchange, lack of inputs, loss of workers, especially skilled workers, and erratic policy changes such as price controls and interest rate hikes. The Director of the Matabeleland chapter of the Chamber of Industries and Managing Director of ¶C. Gauche, a hardware and coal manufacturer, Dumisani

Sibanda, estimated that companies with direct links to the mining industry were operating at about 65 percent capacity, other firms were operating at about 30 to 40 percent capacity except those that depended on imports--their capacity utilization had fallen to 15 to 20 percent. Nonetheless, these companies were maintaining a position in the market and a rare few were even doing well, employing similar strategies for dealing with the policy environment that can be broadly grouped into three categories: 1) diversify; 2) work around the rules; and 3) manage costs.

Coming up Short

3.(C) Companies universally complained about the lack of foreign exchange available for purchasing imported inputs. Companies that do not earn their own hard currency by exporting, such as Mutare Garment Manufacturers, now buy fabric from more costly third party importers because they cannot get hard currency or because they choose not to engage in the parallel currency market to import directly. LonZim, a subsidiary of the conglomerate Lonrho, has its parent company pay its rent because the USD 1000 is difficult for LonZim to earn in hard currency, but it is peanuts for Lonrho, according to LonZim CEO Geoff Goss. Exporters face constraints as well. Bata Shoes in Gweru*-once the most profitable division in the entire Bata Group--has seen its monthly foreign exchange earnings fall from USD 1 million to USD 450,000; it needs USD 600,000 to USD 700,000 a month to maintain its current level of production and must turn to the parallel market to make up the difference, according to

Managing Director E.M. Duthie. Expenses as a percentage of turnover had risen from 15 percent to 32 percent. Bata, a vertically integrated factory, normally keeps 6 weeks worth of leather and rubber in stock, but in early April had entire warehouses of empty shelves because there was no foreign exchange to purchase inputs. In the months running up to the 29 March elections, companies also began to see delays in processing of payments from their Foreign Currency Accounts at the Reserve Bank of Zimbabwe. Duthie said the lack of payment by the Reserve Bank to his South African suppliers of rubber and other inputs for shoes and spare parts for machines was jeopardizing the relationships he had built up over decades.

4.(C) Shortages of domestically produced inputs from raw materials to electricity have also cut production levels. Haggie Rand, a fencing company, has seen its turnover decline by 75 percent in real terms in the past four years and its capacity utilization has dropped to 15 percent now that it must import steel. The parastatal steel manufacturer ZISCO stopped making the required grade of steel used by Haggie Rand eight years ago. Chitiy Laxmidas, owner of safari clothing manufacturer Style International, said the company had lost 50 percent of its production because it cannot get adequate amounts of fabric and trim and sometimes only has power one day per week, cutting production time. Sino-Zimbabwe Cement has also lost production due to electricity shortages, and Tongai Muzenda, the CEO of ZimAlloys, a chrome mining and processing company, said electricity outages alone had cut refining capacity by 30 percent.

But Companies Make a Plan

5.(C) Companies deal with the shortages of foreign exchange and other inputs by cutting a special deal or resorting to the black market. The most successful companies negotiate to retain all of their foreign exchange and export most, but not all, of their production. David Lasker, Managing Director of Archer Clothing has actually expanded his production with

turnover growing by 10 percent in real USD terms last year in large part because he exports 90 percent of his garments and has negotiated to retain more than 65 percent of his forex earnings. (NOTE: Lasker did not disclose how much of his foreign exchange he is able to retain, but judging from other companies, he likely retains 90 to 100 percent. END NOTE.) Bata also retains 100 percent of its forex earnings, but exports much less, largely because Chinese competition makes profit margins very low outside of Zimbabwe. Both firms made a business case to the Reserve Bank, citing their employment levels and hard currency needs. Other businesses, however, rely on their political connections (Ref C). Neither strategy is foolproof, however, as Sino-Zimbabwe Cement shows; its majority owner is a Chinese parastatal and it employs between 400 and 500 people, yet it gets no special deals from the Zimbabwe government.

6.(C) Companies that cannot get enough hard currency from the Reserve Bank are forced to either buy it from the black market or go without. Haggie Rand and Mutare Garment Manufacturers refuse to engage in parallel market currency trade. Corporate headquarters in the U.S. prohibited Colgate-Palmolive Zimbabwe and Johnson & Johnson from dealing on the black market, which led to their demise (Ref A).

Bata, however, sources about 35 percent of its forex needs on the parallel market, which raises the final cost of a pair of shoes by 30 to 40 percent, according to Duthie. Though exporting more might seem to be a viable way to earn more hard currency, companies cannot export their entire production because they need local currency to pay their local costs, plus they need to maintain market presence. Style International sells 10 to 15 percent of its production in the local market to keep brand recognition, and Bata has kept more than half of its retail outlets open without any shoes on the shelves simply to show presence (and to prevent the authorities from thinking the company is closing down or abandoning the market). One business registry company was doing a booming business registering shell companies used by legitimate entities to subvert the limits on local currency withdrawals. It is difficult to make payroll when the minimum wage is two and half times the daily withdrawal limit.

7.(C) Supply shortages have made companies extremely resourceful and innovative. Laxmidas tried to source spare parts legitimately from South Africa, but found the Reserve Bank,s paperwork requirements extremely costly and time consuming; he therefore resorted to the black market which was faster and cheaper. Bata recycles old rubber boots and reprocesses every scrap of material from leather to rubber, and even sends workers out to collect tire scraps from the road to reprocess into shoe soles. Bata and Style International also rely on old mechanical machines that are easy to fix rather than upgrading to high-tech computerized sewing machines.

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Willy-Nilly Policy Changes Call for Diversification
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8.(C) Companies coped better with shortages than with the ever shifting policy environment. Sibanda complained that Reserve Bank policies made without any reference to underlying conditions prevented companies from planning. Muzenda suggested that even consistent bad policy would be better for business than the current inconsistent policy environment. The imposition of price controls without regard to underlying production costs wiped out the working capital of many businesses. Sibanda, who completed a study of the past 7 years' worth of Hwange Colliery's operations, said price controls on coal sold to power plants--60 percent of Hwange's production--had damaged Hwange's assets. Best Doroh, chief economist at ZB Bank, noted that many companies shied away from debt because sudden increases in interest

rates could wipe out a company's balance sheet, but this deprived banks of their best customers--large corporates.

9.(C) To avoid price controls, increase revenue, and make the best use of available supply, companies diversified their product mix to spread the risk of a loss in one area. Some manufacturers moved up the value chain sacrificing volume for value added, like Haggie Rand which stopped producing high volume, low value-added black-mile steel cable in favor of more expensive barbed wire and diamond wire. Bata, on the other hand, has begun to produce cheaper canvas shoes that require about one-quarter of the rubber that the higher priced rubber boots require. Bata has also begun to make rubber boots out of PVC rather than natural rubber. C. Gauche has diversified into flour and peanut milling and fasteners such as bolts and screws in addition to coal processing.

Sino-Zimbabwe cement began to make masonry cement, initially because it used more slag, which was discarded during steel production. (Now, because ZISCO has so little steel to sell, it charges for the slag, making masonry cement more costly to produce than higher-grade Portland cement.)

10.(C) Again, special deals help companies cope with price controls. Sibanda, who is on the National Income and Pricing Commission (NIPC) was able to secure a 3,000 percent increase in the price of coal sold to power stations to make the sales viable. Hwange, however, still needed USD 50 million for new equipment, to purchase 3 additional continuously-operating water pumps for example. Shingirai Munyeza, the CEO of hotel firm ZimSun and Chairman of the Zimbabwe Tourism Authority, negotiated an increase in prices by offering special prices for government employees at Zimbabwe's hotels with a 2 week review, knowing that many government employees would not have the required paperwork to take advantage of the incredibly low rates. Marvelous Rambire, the manager of the Holiday Inn in Mutare, a ZimSun property, said the NIPC took too long to review the prices, so they raised prices and simply risked getting caught.

Labor: The Most Difficult Challenge

11.(C) Labor shortages have been one of business' hardest challenges. Hyperinflation has eroded the value of wages such that Zimabweans earn much less than workers in neighboring countries. Moreover, hyperinflation outpaces changes in tax policy, so even with April's increase in income brackets, the lowest paid workers earning above a low tax-free threshold of ZWD 1 billion (roughly USD 11/month) still pay 25 percent of their wages in tax. Derek Moyo, Managing Director of Sino-Zimbabwe Cement, says his workers leave without even giving notice. They used to want to collect their last paycheck or severance package, but now the money is worth so little it's not worth staying a few weeks more to collect it. Commercial agriculture has seen devastating losses in labor, especially skilled labor (Ref B). Laxmidas said Style International experiences 15 to 20 percent staff turnover every month. Muzenda said retaining employees in the mining sector was a serious challenge as their skills were in short supply worldwide. After completing a two year training program, a new employee would only stay one year with ZimAlloys before leaving for South Africa, Australia or England. Sibanda reported that C. Gauche was unable to find a qualified candidate for Finance Director and Hwange Colliery was not appointing qualified candidates because of political interference. As a result Hwange was only extracting coal. No mining development--a process that should lead extraction by 12 to 18 months--had been done since 2005.

12.(C) Many employers supplement wages eroded by hyperinflation with commodities, though this is difficult for large employers such as Bata or Sino-Zimbabwe Cement and it forces companies to spend significant resources finding,

buying, distributing and accounting for non-core business activities like procuring staple foods. Many large companies will pay some portion of their employees in foreign exchange. An executive secretary at Zimbabwe Platinum Mines (ZimPlats) earned USD 1600 per month plus a portion in local currency, but still had her eye out for a job that paid entirely in hard currency. Other companies such as Style International and ZimAlloys offer training programs, though this serves

more to attract new staff than to retain current employees. Tanganda Tea Estate (Ref B) was forced to hire a 70-year-old engineer out of retirement because it could not find a suitable younger candidate.

¶13. (C) Price controls, labor losses, and supply shortages*-all of which can hit without warning*-force companies to cut costs. To get through periods of low production*-or no production if electricity outages shut a plant down*-companies reduced their fixed costs, such as overhead, and increased their variable costs, for example by hiring contract workers. Companies have also shortened their planning horizons. Laxmidas said his company now has a 48-hour planning cycle while Lasker said his company has daily cash management.

Buoyant Firms Could Recover Quickly

14.(C) Recovery in many sectors could be very quick because there is so much capacity sitting idle in Zimbabwe and demand is suppressed by supply shortages. With adequate money and inputs, companies would race to fill unmet demand. Muzenda estimated that six months after receiving the first penny of investment, ZimAlloys could be producing chrome again. The quickest mine to recover would earn USD 10 million/month. It would take nine months to rehabilitate a second mine, and the total operation could earn upward of USD 20 million/month in finished chrome and other alloys within a year. Muzenda's coal mining operations started only a year ago and were already exporting. Sibanda said gold mines have increased their proven reserves by 25 percent by spending money on development rather than on production waiting on price controls to be lifted. Laxmidas says the company could return to full production within two weeks if it had adequate fabric and felt that other manufacturers could return to full capacity within 30 days with a change in exchange rate and inflation policy. Many manufacturers such as Style International and Bata have kept old mechanical equipment because it is easy to repair and easy to make the spares to facilitate their return to full production. Laxmidas also thinks that many skilled workers in the garment industry have not left the country but are operating in the informal market with a sewing machine in their home. These people will return to formal employment when wages rise again*-and hold their value. Sibanda estimated that C. Gauche needed only a month to order spare parts before restarting its coal operations.

COMMENT

15.(C) Zimbabwe's challenges are many and recovery will not be easy. Some firms may fall under the burden of rising wages or debt costs as the currency revalues and interest rates become positive in real terms. These companies, however, benefit, for now, from being semi-monopolies in an economy where so many businesses have failed, and many have experience with tough times from the days of blanket sanctions in the 1960s and 70s. END COMMENT.

DHANANI